Siebel Systems, Inc.

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Siebel Steps Into Rule Maker Territory

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MOTLEY FOOL RESEARCH

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LINKS

- Siebel Resources
- Siebel Discussion Board
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COMPANY INFO

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REPORT OVERVIEW

- **Siebel Systems** (Nasdaq: SEBL) is a leading provider of customer relationship management (CRM) software. Explosive demand for CRM applications has created tremendous opportunities for software providers in this space. Forrester Research estimates that the CRM space will grow 50% compounded annually over the next few years.

SO WHAT:

- Siebel leads the rapidly evolving CRM space with over 20% market share. During Q1 2000, Siebel's revenues increased 119% year-over-year. License revenue grew at an equally blistering pace of 104% year-over-year.

- The acquisition of OpenSite and the release of Siebel 2000 will strengthen the company's product offerings to include Web-enabled applications and dynamic pricing software.

- The primary risk facing Siebel is execution risk. Managing explosive growth and fulfilling customer demand will be difficult. These challenges plus increasing competition from enterprise resource planning (ERP) and CRM point providers make execution crucial for long-term success.

NOW WHAT:

- We subjected Siebel Systems to the gauntlet of The Motley Fool's Rule Maker criteria, which are used to find superior large-cap growth stocks. The company met 9 out of 10 criteria in our framework, so for Rule Maker investors, Siebel is worthy of consideration.

FOOLISH RATING

Industry Attractiveness
Position in Industry
Business Quality
Investment Predictability
Overall Prospects

Explanation of Criteria on page 9.

QUARTERLY FINANCIALS

(in millions, except per share)	Q1 2000	Q4 1999
Net Sales	$309.4	$289.7
Gross Profit	$234.7	$221.1
Net Income	$46.3	$44.2
EPS	$0.19	$0.18

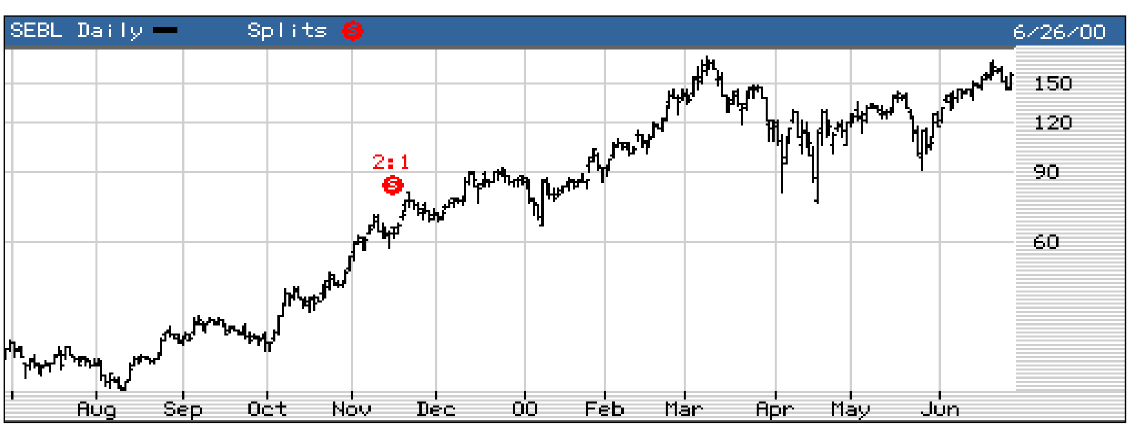
ANNUAL FINANCIALS *(fiscal year ending 12/31/99)*

(in millions, except per share)	1999	1998
Net Sales	$790.9	$409.9
Gross Profit	$610.0	$338.9
Net Income	$122.1	$44.3
EPS	$0.54	$0.21

QUOTE & BALANCE SHEET INFORMATION

TTM Range	$23.47 - $175.13
Shares Outstanding	242.5 million
Market Capitalization	$30.6 billion
P/E Ratio	243.65
Dividend Yield	N/A
Q1 2000	
Cash, Equivalents, & Marketable Securities	$873.8 million
Total Assets	$1,428.5 million
Long-Term Debt	$300.0 million
Total Liabilities	$621.6 million
Shareholder Equity	$806.9 million

SIEBEL'S STOCK PRICE OVER THE PAST 12 MONTHS



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Siebel Systems is the leading provider of customer relationship management (CRM) software applications. The proliferation of the Internet has allowed enterprises to interact more effectively with customers. For instance, customers can now request service via call centers, fax, or self-service functions online. Companies can also collect richer data to attract and retain customers. As a result, the demand for CRM applications has been explosive. This strong demand and a market-leading position have catapulted Siebel Systems into near-Rule Maker status.

BUSINESS DESCRIPTION

Siebel Systems, located in San Mateo, California, is a leading provider of customer-facing software applications. It was founded in 1993 by Tom Siebel, a former Oracle salesman. Siebel's software applications provide a full suite of tools for marketing, sales, and customer service support functions, which aid companies in identifying, retaining, and attracting customers.

INDUSTRY ATTRACTIVENESS

The dynamics of the economy have changed. Many businesses are no longer price-setters, but are price-takers. In the old economy, when companies began to lose pricing flexibility from customers, they began to restructure their business processes to remain profitable. In the wake of falling prices and increased competition from foreign markets, just-in-time inventory and mobile labor became crucial to reduce product costs and overhead and to improve productivity and profitability. Firms that adopted these streamlined business processes were able to develop an advantage relative to their competitors.

Today, however, it is not uncommon to see zero-inventory business models, outsourced labor, and increased use of technology to enhance productivity. Now, information creates competitive advantage. Effective use of information to identify, attract, retain, and foster relationships with customers can help a firm gain a competitive edge. Customer relationship management software is a tool that businesses can use to build and leverage their relationships with customers.

E-BUSINESS

Many firms, both of the old economy and 'Net economy variety, are adopting e-business models. By transferring business processes to the Internet, e-businesses can capitalize on the efficiencies of streamlining business processes and increasing worker productivity. For example, many functions have become self-service in design, reducing administrative tasks and improving relationships with customers.

An e-business integrates both external (CRM) and internal (ERP) business processes via the Web. Examples of ERP functions include human resources and procurement. CRM includes areas such as sales and marketing.

CRM tools help create a seamless organization that provides employees with mission-critical information and real-time feedback; empowers them to analyze and make decisions; builds stronger relationships with customers, suppliers, and partners; and fosters competitive advantage. Richer marketing strategies and sales tactics predicated on better data, combined with superior customer service, can lead to increased top-line growth and profitability.

A major theme underlying the shift to the Web is the desire to have key information available throughout an organization on a real-time basis. The traditional client/server architecture fragments data and decentralizes it. The Internet provides the benefit of centralized data and real-time feedback with a more economical architecture. All that is needed is an industry-standard Web browser (e.g. Internet Explorer), and companies are on their way. Businesses can then capitalize on the Internet to market and sell products, communicate with customers, and electronically link with business partners.

The Internet creates a new communication and distribution channel with the customer. Its mass customization possibilities promote a customer-centric business model. Product offerings and marketing strategies can be tailored to customer tastes and preferences. Support and service can be achieved through call centers, phone, fax, and e-mail.

CUSTOMER RELATIONSHIP MANAGEMENT (CRM) SOFTWARE

The customer-facing processes discussed above can be achieved by utilizing CRM software. Siebel competes within a segment of the e-business software arena that focuses on providing tools for enterprises to identify, attract, retain, and leverage relationships with their most important asset — their customers. Because companies are scrambling to leverage the power of the Internet to enhance relationships with their clients, the CRM market is one of the fastest growing segments of the application software market. Companies use CRM applications to provide employees with a better view of customers and to enable customers to interact more effectively with all channels within an organization.

The Internet creates a new communications and distribution channel as well as a new consumer experience. Potential customers can easily click through to a competing offer, and online stores are expected to be open 24 hours a day, 7 days a week. The Internet also provides a means to gain more information from customers to provide customized products and targeted marketing campaigns.

Customer relationship management applications can be divided into several functional areas:

- **Marketing** applications allow users to gain better information about customers, analyze competitors, and create richer marketing campaigns that target products to the most viable markets.

- **Sales** applications (for both field and office) allow remote users to have real-time access to critical information about inventories and product configurations.

- **Customer service and support** applications enable telesales, customer service, and technical support.

- **Industry-specific** CRM applications can be targeted towards a particular industry, such as retail or insurance. For example, one of Siebel's many industry-specific applications is targeted at the shoe industry. The application helps shoe companies manage sales and marketing campaigns more effectively, taking into account factors like styles, colors, and seasons.

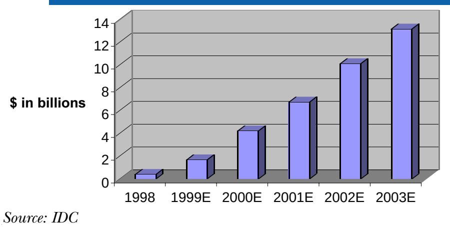
- **Partner management** applications assist in the recruitment of business partners. The software allows users to analyze joint ventures, planning, sales forecasting, and joint marketing campaigns.

- **Self-service** functions allow customers to request service, view online catalogues, order online, and check the status of their order.

INDUSTRY GROWTH

The CRM software sector is experiencing warp-speed growth, as shown below. Forrester Research estimates that the CRM market will grow more than 50% annually during the next several years. Historically, industries in overdrive attract a multitude of competitors vying to carve out their turf and reap the rewards of market dominance. Some companies will offer point solutions focused on one particular area of CRM, while others will sell software suites intended to provide a complete CRM solution to users.

CRM License Revenue Growth



Source: IDC

Technological adoption is a crucial factor. In order for CRM to be a sustainable sector with long-term growth prospects, corporate buyers will have to embrace customer-facing applications. According to AMR Research, approximately 71% of CRM users were in North America in 1998, compared with just 21% in Europe and 2% and 5% in Latin America and Asia, respectively. Clearly, there is room to grow.

The benefits are overwhelming and include both improved productivity from employees and better information about customers. Therefore, it looks like 50% growth rates should be achievable.

RATING

The CRM space is on fire, and many players want a piece of the action. Adding CRM capabilities to e-business application suites will only enhance the product offerings of the leading software vendors.

INDUSTRY ATTRACTIVENESS

POSITION IN INDUSTRY

In the next two sections of this report, I will address Siebel's position in the industry and its quality of business by subjecting the company to The Motley Fool's Rule Maker criteria. The qualitative criteria of a Rule Maker will be used to assess whether or not Siebel's position in the industry will likely grow or erode, while the quantitative criteria will be used to analyze the strength of the firm.

Rule Maker Qualitative Criteria

- Dominant brand
- Expanding possibilities
- Repeat purchase business
- Convenience
- Interest and familiarity

DOMINANT BRAND

The competitive landscape has rapidly evolved during the formative stages of the CRM application industry. In 1998, Siebel Systems acquired Scopus Technology, an early leader in CRM applications. The acquisition allowed Siebel to scale quickly. Both revenues and customer breadth allowed the company to exert a strong position in the industry. Two other competitors, Vantive and Clarify, were recently acquired by **PeopleSoft** (Nasdaq: PSFT) and **Nortel** (NYSE: NT), respectively. These acquisitions effectively minimized the competitive threat from major pure-play CRM providers.

However, while the threat from pure-play providers has been minimized, Siebel now faces competition from suite vendors. For example, while Vantive's direct competition was eliminated by the acquisition by PeopleSoft, the latter has effectively bought its way into the space and can now offer a broader solution to its customers. Siebel also faces competition from traditional enterprise resource vendors such as **SAP** (NYSE: SAP) and **Oracle** (Nasdaq: ORCL), which are making an aggressive play for the CRM market.

Oracle's threat looms particularly large. While some competitors enter the space through acquisitions, Oracle develops many technologies internally. The company's CRM business grew 179% during Q3 of its fiscal 2000. Its strategy centers on providing a fully Web-enabled end-to-end software solution (including ERP and CRM). Customers desiring one-stop shopping for their application needs or who are concerned about compatibility issues are likely to consider vendors such as these, which offer a comprehensive applications suite.

Siebel also faces stiff competition from middle-market CRM vendors. The traditional ERP vendors will gain share from their installed user base, but the middle-market providers often lie under the radar screen of the Oracles and Siebels of the world. Hence these middle-market players can gain share via new application users.

Finally, point providers pose a competitive threat in the CRM space. Point providers focus on a specific application and seek to carve out a dominant position within a niche. An example is **Davox** (Nasdaq: DAVX), which offers call center applications. However, Siebel is becoming synonymous with CRM applications, a sign of brand dominance.

Here is a breakdown of current CRM market share:

CRM Market Share

Company Name	CRM Market Share (1999)	Price-to-Sales Ratio
Siebel Systems	21.1%	27.50
Clarify/Nortel	6.1%	5.85
Oracle	5.5%	20.89
Vantive/PeopleSoft	5.5%	2.73
Dendrite	4.6%	5.64
Baan	3.7%	0.52
Broadvision	3.1%	65.94
Davox	2.5%	3.20
Pegasystems	1.8%	2.24
SAP	1.6%	N/A
Applix	1.5%	1.44
ONYX	1.5%	8.58
Others	41.5%	N/A

Source: AMR

Clearly, Siebel is the current market share leader in the CRM space. With the introduction of Siebel 2000 (Web applications) as well as voice recognition and wireless software, Siebel should be able to sustain and grow its lead as a CRM provider. The market also recognizes Siebel as the leader through its premium price-to-sales ratio relative to most competitors. Oracle carries a hefty price-to-sales ratio as well; however, it competes in relational databases, ERP, and other enterprise applications in addition to CRM. Notably, **Baan** (Nasdaq: BAANF) possesses 3.7% market share and is in financial trouble. One of the leading players could bolster its position in the competitive environment by acquiring Baan.

EXPANDING POSSIBILITIES

Expanding possibilities are what the stock market is trying to price into shares of Siebel. Competitors are working to carve out their turf via acquisitions or developing products in-house, but Siebel can play that game, too. Siebel has been active on the acquisition front, using its highly valued stock as currency to build scale. Beyond the Scopus merger, which thrust Siebel into the forefront of the CRM space, the company has made other acquisitions as well.

For example, it recently acquired OpenSite, a provider of Web-based auction and reverse-auction dynamic pricing tools. The acquisition strengthens Siebel's e-business applications suite and introduces new competition with **Ariba** (Nasdaq: ARBA) and **Commerce One** (Nasdaq: CMRC). OpenSite also serves as an application service provider (ASP) that permits companies to outsource their auction technology needs.

Siebel also recently released its eCRM (Web-enabled) applications suite, Siebel 2000. The release of Siebel 2000 expands the company's product offering beyond client/server architecture and toward Web-enabled applications and wireless and voice recognition markets. The long-term growth potential of these segments presents a tremendous opportunity. But Siebel will have to contend with niche players in the eCRM space.

Through its strong position in the broader CRM space, Siebel can leverage its relationships with customers to gain entry with its Web-enabled applications. This may effectively close the door to many smaller players even if their technology is superior or more comprehensive. Thus, consolidation in this part of the industry is likely. Siebel also provides easier integration capabilities with systems from Oracle, SAP, and **J.D. Edwards** (Nasdaq: JDEC) than its competitors. This may minimize the threat from these major players since compatibility issues have been diminished.

Siebel has proven the adage if you can't buy it, join it. Siebel has entered into a strategic relationship with **i2 Technologies** (Nasdaq: ITWO), the supply-chain management software provider. This partnership will be mutually beneficial in that the two companies can leverage off of each other's core competencies (CRM and supply-chain management). Siebel has also developed a partnership with **Palm, Inc.** (Nasdaq: PALM). The Palm alliance will help Siebel gain a foothold in the personal digital assistant market and provide e-business solutions to handheld users. Strategic partnerships will continue to be a key factor in driving expanding possibilities for the company.

REPEAT PURCHASE BUSINESS

Software applications are a perfect repeat-purchase business. Software upgrades and product innovations drive future sales to new users as well as to the installed user base. And as Siebel's applications become installed across a larger user base, services and support will become a larger part of its business, adding to the overall sales of the company. Once a sale is made, a long-term relationship is established with the client in order to fulfill current and future needs for CRM and e-business applications.

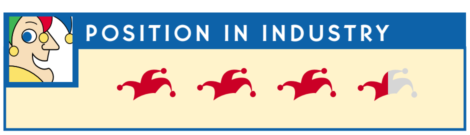
CONVENIENCE

Siebel's products provide convenience to its customers in two forms. First, managing relationships with customers is a necessity for any business. Therefore, tools that provide better information about customers and facilitate the analysis of trends, purchasing habits, and ways to serve customers will provide a substantial benefit to the companies that use them. Siebel's products fulfill this need on the part of corporate buyers.

Second, Siebel aims to provide a total solution for customer relationship needs. This is because customers are likely to buy from one software vendor that is able to provide a comprehensive, compatible application suite that serves their needs. This eases the burden of having to implement multiple systems and reduces the havoc that can result for the user.

RATING

From our perspective, Siebel meets most of the qualitative Rule Maker criteria. However, interest and familiarity — a very subjective factor — is not addressed here, so individual investors will have to formulate their own opinions on this issue. The thorn in Siebel's side is competition. While competitive threats have been minimized in one respect (e.g. Vantive and Clarify), new entrants threaten to erode Siebel's position (e.g. point players and Oracle). Paying close attention to market share will be important as the landscape evolves.



BUSINESS QUALITY

Achieving economies of scale is critical in the software industry. This must be done in order to capitalize on the attractive margins and revenue possibilities presented to companies that can lock in customers and create a standard around their products.

Siebel is experiencing tremendous growth as it fulfills the tremendous demand from corporate consumers. In this early stage, it is important for Siebel to continue to gain market share in order to lock in customers and create a standard around its product. If this effort is successful, the investment potential for Siebel shareholders is tremendous. Siebel is a leader in its space, and acceleration in its fundamentals continues. In assessing Siebel's business quality, we will perform some quantitative tests from our Rule Maker analysis.

Rule Maker Quantitative Criteria

- Sales growth of at least 10% year-over-year
- Gross margins of at least 50%
- Net margins of at least 7%
- Cash no less than 1.5x total debt
- Foolish Flow Ratio below 1.25
- Cash King Margin of at least 10%

SALES GROWTH OF AT LEAST 10% YEAR-OVER-YEAR

Siebel's total revenues continue to grow at substantial rates annually, and quite rapidly on a sequential basis as well. On an annual basis, revenues grew 84.57% and 92.96% in 1998 and 1999, respectively. Sequentially, total revenues grew by 15% in the recent quarter.

More important, license revenues in the recent quarter grew 104% year-over-year, compared with 66.8% year-over-year from Q1'99. As a result, Siebel is gaining traction in the market and continually building market share. Revenue growth in percentage terms should slow as the base grows larger, but 50% growth for the next couple of years is certainly reasonable. Siebel easily meets the sales growth criterion.

Year–Over–Year Growth

Year-Over-Year Growth	Q1 '00	Q1 '99	FY '99	FY '98
License Revenue	104.3%	66.8%	71.7%	85.3%
Service Revenue	146.7%	112.6%	145.0%	82.8%
Total Revenue	118.7%	80.0%	93.0%	84.6%

Source: Company statements

GROSS MARGINS OF AT LEAST 50%

Gross margins in the software sector are attractive compared with other industries. Siebel's margins are some of the best you will ever find in the universe of common stocks. These margins can be broken into two components: software and professional services. Siebel's software sales typically achieve gross margins on the order of about 98% or more, a truly awesome feat. Services have lower margins, around 40% — still nothing to sneeze at.

Siebel's Gross Margins Breakdown

Siebel's Gross Margins Breakdown	Q1 '00	Q1 '99	FY '99	FY '98
Software License Margins	97.2%	98.6%	98.5%	98.1%
Service Margins	41.3%	46.3%	40.5%	45.1%
Total Gross Margins	75.8%	80.8%	77.1%	83.7%

Source: Company statements

What do you think?
PLEASE FILL OUT THIS QUICK ONLINE SURVEY!

Why are software margins so high, while services carry relatively lower margins? The answer is because the incremental cost of an additional piece of software is virtually zero. The cost of software revenues can be attributed to promotion, packaging, and documentation for the software product. Often, software can be delivered over the Web, even saving the cost of printing a CD-ROM. Services, on the other hand, are more capital intensive, requiring additional personnel and facilities.

Gross margins declined slightly in Q1 '00, and were 75.8% compared with 80.8% for the same period least year. Gross margins also declined sequentially from 76.3% in Q4 '99. Is this a cause for concern? Not really. We would expect margins to recede, as Siebel must hire employees to provide consulting, training, and implementation services. This is a good sign. It means that the software products are in high demand and that services are required to support the sales activity.

Typically, Siebel includes a one-year service contract with the sale of a software system. However, as its installed base of users continues to grow over time, additional services and maintenance will be needed. Service revenues could be expected to grow in accordance with the demand for additional support from installed users.

Siebel's gross margins are clearly above the 50% benchmark and should remain in sky-high territory, especially if the company continues to grab market share and become the standard in CRM.

NET MARGINS OF AT LEAST 7%

Net margins for the quarter were 14.95%, comfortably above our 7% benchmark, but down slightly from 15.5% during Q1 '99. Year-over-year, Siebel ramped up its sales and marketing expenses (increasing 130%) and showed an increase in the cost of professional services and maintenance (up 142%), all of which flow through to the bottom line.

On a fiscal year basis, Siebel's net margins jumped to 15.4% from 10.8% in 1998. The company is beginning to achieve economies of scale, meaning costs are being spread over an ever-larger revenue base and that costs per unit are going down substantially. Hence, margins should remain firm or improve over time.

CASH NO LESS THAN 1.5X TOTAL DEBT

We prefer companies that do not highly leverage their future to fund the present. Some debt is not bad, however. The capital structure (proportion of equity and debt financing) that minimizes the cost of capital will maximize the value of the firm. Debt is a cheaper form of financing due to the tax shields on the interest expense.

Siebel's cash and equivalents are a comfortable 2.91x the book value of its debt, easily exceeding our 1.5x hurdle. In addition, during the last quarter the cash-to-debt ratio improved over the fiscal year-end by 0.23x. Chalk up another point for making some rules.

FOOLISH FLOW RATIO BELOW 1.25

The Foolish Flow Ratio measures how effectively a company manages its working capital accounts. [Flow Ratio = (Current assets - Cash & equivalents)/(Current liabilities - Short-term debt)] During the most recent quarter, Siebel's Flow was 1.28, improving slightly from 1.29 at the end of fiscal 1999. But the Flow still misses our benchmark of 1.25.

Looking closely at the balance sheet, we can see that part of the problem with the Flow has been the dramatic increase of receivables over the course of the past year. At the end of fiscal 1998, Siebel had $126 million in receivables. By the end of 1999, receivables had swelled to $293 million, and increased by another $3.6 million in the first quarter. Is this a cause for concern? Well, the company has many blue chip clients, such as **Dell Computer** (Nasdaq: DELL) and **Bank of America** (NYSE: BAC), so collecting on those sales may not be too much of a concern.

An important metric to pay attention to in addition to the Flow Ratio is Siebel's days sales outstanding. It is not uncommon for software companies to use aggressive techniques (i.e. loose credit terms) to get their product in the hands of many customers. Without mass product adoption, it would be difficult to achieve and capitalize on economies of scale. Keeping an eye on days sales outstanding will help us analyze whether or not Siebel is being too aggressive and assess the possibility of its collecting cash from its customers. Over the past year, Siebel's days outstanding has dropped from 99 to 87, which is a good sign despite the increasing receivables.

Siebel's balance sheet has strengthened recently, with an increase in cash, an improving Flow, and a decreasing days sales outstanding. However, the company is only oh-so-close to meeting our Foolish benchmark. Going forward, we will pay attention to these metrics and look for a continued improvement in Siebel's cash management to see if it can jump over our Foolish Flow hurdle.

CASH KING MARGIN OF AT LEAST 10%

While earnings may be important, cash really is king. It's the old greenbacks that sleep tight in the bank, and which can be used to fund a firm's future operations. We like to see a Cash King Margin (which is calculated by taking free cash flow — or operating cash flow minus capital expenditures — as a percentage of sales) of at least 10%. Siebel jumps over our 10% hurdle just like Edwin Moses in the Olympics. Its Cash King Margin is an awesome 39%. A comparison with Q1 '99 is not meaningful because Siebel was not free cash flow positive during the quarter. On a fiscal year basis, the Cash King Margin has declined slightly from 11.58% in 1998 to 9.71% during 1999. A large portion of Siebel's cash from operations is derived from $62 million in deferred revenues, mostly through an arrangement with IBM. However, even backing out the deferred revenues, the margin is an impressive 28%. Remember, however, that this is just from one quarter, and we will keep our eye on this trend.

RATING

Siebel Systems exceeds 5 out of 6 of our quantitative Rule Maker criteria, and 9 out of 10 total criteria considered. Unfortunately, cash management is critical. Before crowning Siebel a full-fledged Rule Maker, we'll need to keep an eye on the trends developing with the Flow Ratio and the continued strength of the balance sheet. For investors willing to take on some risk, Siebel has all of the signs of making some rules in the CRM space.

INVESTMENT PREDICTABILITY

Rapidly growing industries are inherently unpredictable. In the CRM business, competitors will fight for market share to establish the standard around their products. The winners will win big, while the losers will lose even bigger. There are several factors that represent risks and rewards for Siebel and others in the CRM space.

RISKS

Competition
Customer relationship management producers compete with CRM suite providers, point providers, ERP and database companies such as SAP and Oracle, and companies developing in-house solutions for their CRM needs. However, there may only be a couple of winners left standing when the dust settles and a particular vendor is deemed to have the most attractive platform and offering. When you start hearing the phrase "Nobody ever got fired for buying from [fill in name here]," you have a winner.

Execution
Execution will be crucial as the players in this space must effectively manage growth. Product delays may cause corporate buyers to find an alternative solution. Even a minor slip-up can give a competitor a huge edge that may never be recaptured.

Pricing
Software companies use aggressive marketing techniques to lock in customers and achieve economies of scale. As a result, price wars to capture market share could develop.

Product Pipeline
Continuous product innovation will be a key factor in developing a lead in the market. With wireless and Web technologies gaining greater adoption, vendors will have to act swiftly to provide products that improve the functionality of their existing CRM offerings.

Customer Breadth
Emerging technologies often have small customer bases. As the technology becomes more widely adopted and new customers sign on, the technology provider faces less risk that one major customer could have a significant negative impact on operating results.

REWARDS

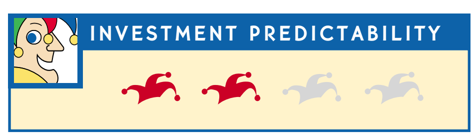
Strong Demand
Companies are scrambling to implement CRM solutions to identify, attract, and retain customers, so technology adoption may not be as much of an issue today as in the past. Fulfilling this demand should accelerate revenues and earnings for the leaders in this space.

Strategic Partnerships
Strong strategic relationships with blue chip technology providers open new market opportunities and give credibility to the software applications. Siebel's recent partnership with IBM has generated substantial revenues for the company and created well over 100 new relationship opportunities.

Product Pipeline
Siebel has aggressively moved into the eCRM space with its release of Siebel 2000. This offering strengthens Siebel's client/server product line. The added compatibility with other software vendors such as SAP and Oracle may reduce the competitive threat from vendors that market a total end-to-end solution. Finally, Siebel's foray into voice recognition and wireless software will enhance the effectiveness of field professionals.

RATING

Siebel's predictability (and that of other players in this space) boils down to building market share and establishing the standard in CRM. Should this play out in the market, the rewards will be significant. Since a winner has yet to be determined, however, Siebel's market capitalization could change substantially as new developments occur, making its stock price quite unpredictable.



OVERALL PROSPECTS

As investors, we do not just want great companies; we want great stocks. If the market has already factored the long-term value we believe a firm may create into its stock price, it is best to move on and find another investment opportunity. Is this the case with Siebel?

GROWTH DURATION

Siebel's growth rate over the past few years has been nothing short of stunning. The CRM application business is likely to remain one of the hottest sectors in the software industry for the next few years, as corporate buyers adopt Web-enabled technologies. But such tremendous growth rates are not sustainable forever; otherwise Siebel would be larger than the entire economy! Just how long would Siebel have to grow at its projected rates to justify its stock price? And is the growth rate reasonable and sustainable? Growth duration helps to shed some light on those issues.

Growth duration = Log (P/E of firm / P/E of the market)/ Log (Total growth of firm/Total growth of market)

Growth Duration

Fundamentals	S&P 500	Siebel Systems
P/E Ratio	28.50	182.07
Projected Growth Rate	15.20%	42.31%
Dividend Yield	1.14	—
Total Growth	16.34%	42.31%
Duration	—	9.21 years

Sources: Zacks, Motley Fool Research, and Bloomberg

Based on this analysis, Siebel would have to grow at its projected growth rate for 9.21 years to justify its current stock price. Whether or not this is achievable depends on the sustainability of Siebel's business model and the competitive environment.

It is also worth noting that leading firms in emerging sectors often appear overpriced because the market systematically underestimates the growth potential of these sectors and the leading companies. Witness Siebel's meteoric stock price increase of 447% over the last 52 weeks. While more investors are catching on to Siebel's growth potential, risk-taking Rule Maker investors should give the stock a closer look.

SUSTAINABILITY

Several factors suggest that long-term sustainability is possible in the CRM space:

- **Barriers to entry:** As the market share leader, Siebel is able to create barriers to entry as corporate buyers adopt a platform for their CRM needs. As Siebel makes more sales and gains recognition in the market, the company becomes the obvious choice for repeat and future purchases. Once a platform is established, the cost of switching creates another barrier to entry.

- **Economies of scale:** Once Siebel has locked in corporate buyers to the platform and has achieved economies of scale, profitability can grow exponentially, as costs are driven down while increasing sales feed the bottom line.

- **Increasing returns:** As the installed base grows larger, more companies are likely to standardize around Siebel's CRM applications.

- **Making the rules:** If a company makes the rules in an industry, it can also break them. This creates competitive advantage by keeping competitors on their toes and fighting to keep pace with industry developments. Creation of long-term shareholder value results.

RATING

Many indicators point toward Siebel as a long-term dominant player in the CRM space. While Siebel's stock is pricey, potential barriers to entry, high switching costs, and increasing returns suggest that the company possesses long-term sustainable competitive advantages that could grow as the sector evolves.

OVERALL PROSPECTS

SUMMARY

Siebel competes in the exciting and rapidly growing CRM applications sector. Competition is fierce, but our analysis shows that Siebel is a possible Rule Maker and primed to become the dominant player in the CRM space. Rapidly evolving industries are inherently risky and each investor must assess his or her own risk tolerance. However, Siebel's long-term rewards could be quite satisfying for investors patient enough to let the horses cross the finish line.

NEWS TIMELINE

04/18/00 ($126.88) — Siebel Systems ships Siebel 2000, the company's eCRM product offering. Siebel 2000 includes expanded dot-com functionality as well as pre-built connectors for other software applications from Oracle, SAP, and J.D. Edwards. It also supports wireless technology for field professionals.

05/18/00 ($130.13) — Siebel Systems completes the acquisition of OpenSite. The new products will be renamed Siebel Dynamic Commerce and will be included as a part of Siebel's eCommerce products.

05/22/00 ($113.25) — Siebel Systems enters an agreement with **Quintus Corporation** (Nasdaq: QNTS), a leading provider of contact center solutions, to market and sell Siebel's eBusiness software applications. The pact will allow both companies to leverage channel and technology strengths and increase their footprints in the CRM space.

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06/01/00 ($129.88) — Reuters, a leading provider of financial news and analysis, chooses Siebel Systems to provide eBusiness applications to support its global operations.

06/06/00 ($136.94) — Siebel Systems and IBM announce they will begin selling software applications tailored for the airline industry. The applications will help airlines sell tickets through online stores, provide customer support, and manage maintenance and repair scheduling and data.

ABOUT THE FOOLISH ANALYST

John Del Vecchio (a.k.a. TMFFuz) converted from the ways of the Wise in December 1999 when he came to The Motley Fool as a research analyst. In his former life as a quantitative analyst on Wall Street, John worked for the international division of a large institutional asset manager. John has worked for James O'Shaughnessy at O'Shaughnessy Capital Management in Greenwich, Connecticut, and is a candidate for level 2 of the Chartered Financial Analyst designation. While not working on Foolish research, he likes to travel, eat good food, and sleep. He was a big fan of the Yankees and Denver Broncos when they were terrible. So, his timing is always questionable. Questions, comments, and snide remarks can be directed to John at JDelVecchio@Fool.com

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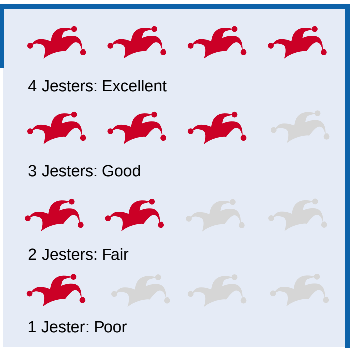
At the time of publication, the author owned shares of Siebel Systems, Inc.

EXPLANATION OF CRITERIA



Industry Attractiveness measures an industry's potential and dynamics, including quality of sales (i.e. gross margins on typical industry sales) and more. **Position in Industry** seeks to measure where a company stands in its industry; is it the top dog, or is it a second-tier follower? Only leaders are rated excellent. **Business Quality** addresses the economics of the specific business being studied. How profitable is it or can it be? What is the potential return on capital in the business? **Investment Predictability** takes into account the stability of a business. **Overall Prospects** rates the analyst's opinion of the company's and the stock's long-term potential, as well as valuation. This rating wraps up the whole enchilada, from business quality to management to industry position and valuation. Long term is at least three years, but typically much longer.

For more information on how to use these ratings, click here, or visit Fool.com/research/about/ratings.htm.

SIEBEL SYSTEMS, INC. FINANCIALS — QUARTERLY

($ in millions, except EPS)

BALANCE SHEET	Q1 '00	Q4 '99	Q3 '99	Q2 '99	Q1 '99
Cash & Equivalents	$873.8	$805.3	$671.1	$352.4	$230.5
Inventories	—	—	—	—	—
Receivables	296.6	293.0	213.7	173.3	147.7
Total Current Assets	1284.9	1,129.0	917.6	555.2	405.3
Net Fixed Assets	79	56.9	43.5	37.1	48.3
Total Assets	1428.5	1,227.0	980.9	604.3	468.3
Accounts Payable	4.9	11.8	15.4	13.2	12.0
Total Current Liabilities	320.1	250.9	209.7	181.6	136.6
Total Liabilities	621.6	552.4	510.0	181.8	137.2
Total Equity	807	674.6	470.9	422.5	331.1

INCOME STATEMENT					
Sales	309.4	289.7	195.3	164.4	141.5
COGS	74.8	68.6	48.5	36.8	27.1
Gross Profit	234.7	221.1	146.9	127.7	114.3
General & Administrative	150.5	133.4	83.4	71.8	65.1
Pretax Income	74.6	71.8	49.8	40.9	34.5
Net Income	46.3	44.2	30.1	25.8	22.0
Diluted Weighted Average Shares	242.5	251.1	222.4	215.4	216.3
Diluted Net EPS	0.19	0.18	0.14	0.12	0.10

STATEMENT OF CASH FLOWS	3 months ended 3/31/00	12 months ended 12/31/99	9 months ended 9/30/99	6 months ended 6/30/99	3 months ended 3/31/99
Operating Cash Flow	147.9	119.6	73.7	32.9	(5.6)
Investing Cash Flow	(73.1)	(96.3)	(22.9)	(10.8)	(1.0)
Financing Cash Flow	28.3	362.0	335.3	30.8	12.2
Depreciation & Amortization	8.1	22.3	14.9	10.1	4.8
Fixed Asset Purchases	(26.6)	(42.8)	(24.9)	(14.2)	(8.0)
Gross Margin	75.86%	76.3%	75.2%	77.7%	80.8%
Net Margin	14.96%	15.3%	15.4%	15.7%	15.5%
Other Operating Expenses as a % of Sales	80.06%	77.6%	76.0%	76.3%	77.2%

Sources: Company filings

What do you think?
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SIEBEL SYSTEMS, INC. FINANCIALS — ANNUAL

($ in millions, except EPS)

BALANCE SHEET	1999	1998	1997
Cash & Equivalents	$805.3	$232.6	$162.2
Inventories	—	—	—
Accounts Receivable	293.0	126.1	63.1
Total Current Assets	1,129.0	386.4	236.7
Net Fixed Assets	56.9	46.4	24.8
Total Assets	1,227.0	447.6	268.2
Accounts Payable	11.8	4.6	5.7
Total Current Liabilities	250.9	155.7	58.6
Total Liabilities	552.4	156.5	58.8
Total Equity	674.6	291.1	209.4

INCOME STATEMENT			
Sales	790.9	409.9	221.1
COGS	180.9	71.0	36.0
Gross Profit	610.0	338.9	186.0
General & Administrative	354.2	213.4	124.8
Income Before Tax	196.9	74.3	13.9
Net Income	122.1	44.3	0.6
Diluted Weighted Average Shares	226.3	202.2	191.3
Diluted Net EPS	0.54	0.22	0.00

STATEMENT OF CASH FLOWS			
Operating Cash Flow	119.6	87.1	21.7
Investing Cash Flow	(96.3)	(99.0)	(37.5)
Financing Cash Flow	362.0	22.3	7.8
Depreciation & Amortization	22.3	13.6	8.3
Fixed Asset Purchases	(42.8)	(39.6)	(18.0)

Sources: Company filings

Hey Fool!
What do you think?

Thank you for taking the time to read this Motley Fool Research report. We hope you now know what we mean when we say our goal is to provide the most candid, clear, and useful stock research available to the individual investor.

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